UNITED STATES DEPARTMENT OF AGRICULTURE
Bureau of Agricultural Economics

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THE OUTLOOK FOR THE NATIONAL INCOME

out look

Address by S. Morris Livingston, Chief, National Economics Division, Office of Business Economics, U. S. Department of Commerce, at the 25th Annual Agricultural Outlook Conference, Washington, D. C., November 3, 1947

Appraisal of the outlook for the national income necessarily stems from an analysis of developments since the last Agricultural Outlook Conference and an evaluation of present tendencies. For this purpose it is convenient to talk in terms, not of the national income, but of the gross national product.

As most of you know by now, the gross national product is the market value of all goods and services produced. It is larger than the national income because there is included in the value of those goods and services the costs such as depreciation and business taxes, which do not accrue to any individual as income.

All of the goods and services produced go to four broad markets. These are government purchases, business capital outlays, our net exports, and consumer expenditures. These four markets determine whether aggregate demand is more or less than sufficient to absorb all that can be produced.

The sharp decline in Government expenditures for goods and services from the wartime peak of 100 billion dollars to less than 30 billions had already occurred at the time of the last Conference. Since then this one of the four markets has been a stable rather than dynamic influence in the economy. Including State and local governments, outlays are at a slightly higher rate today than they were a year ago but a slightly smaller share of the increased dollar value of total national output. Efforts at further reduction of the Federal budget have been offset elsewhere by rising prices and resumption of peacetime public works construction.

Any major changes in Government expenditures for goods and services in the coming months will occur only as the result of new legislation--such as the foreign aid program.

Business capital outlays can be divided into three categories: equipment, construction, and inventories. Outlays for producers' durable equipment rose rapidly from an annual rate of 6 billion dollars in the spring of 1945 to 18 billions in the spring of 1947. Since then they have leveled off.

These outlays are at a very high rate. If continued indefinitely, they would be more than sufficient to maintain the country's physical plant and provide for a normal growth in capacity. That, however, does not necessarily preclude a continuation, or possibly even some further increase, over the present rate in 1948.

Any near-term reversal of general business trends is not likely to originate with a decline in equipment outlays. Unfilled orders are still large, although no longer increasing. The backlog of demand for some types of equipment is running out but demand for other items appears sufficient to absorb more than can be produced in the coming months. Expenditures for these items will tend to expand as production bottlenecks are eliminated.

On the other hand, equipment outlays from here on are likely to reflect rather than offset any weakness developing elsewhere in the economy. In general the as yet unsatisfied demands are not so urgent but what any serious doubts as to the future trend of business, or of prices, could produce hesitation all along the line.

Construction activity, including residential construction, also rose rapidly from an annual rate of less than 3 billion dollars in the spring of 1945 to over 10 billions in the spring of 1947. At that point there was some hesitation induced by the sharp run-up of costs and by the hope or expectation that those costs would come down in the near future. The urgency of the demand, however, prevented any significant decline. In spite of high costs the upward trend in activity has been resumed.

Construction is likely to be an element of continuing strength in the economy. The backlog of deferred demands is still large--although much of that demand is deterred, not only by high costs but also by uncertainties as to costs and completion dates and other disadvantages of building under present conditions of inadequate supplies of materials and manpower and lack of effective competition.

Any serious weakness developing elsewhere in the economy would tend to revive the hope that more favorable terms could be got by delaying construction projects. Any resulting decline in activity, however, plus any lessening of demand from other segments of the economy, would release additional materials and manpower. It would also mean a shift from sellers' markets to buyers' markets all along the line from ultimate raw materials to finished product. The realization of those more favorable conditions would tend to revive projects which are now dormant.

Inventory accumulation, which is the third category of business capital outlays, reached a peak in the second half of 1946 when the increase in the book value of business inventories was at the annual rate of over 15 billion dollars. Part of this reflected increased physical quantities and part reflected the higher cost of replacing the same physical stocks.

This peak was followed by a wave of caution, particularly on the part of retailers, in the spring of 1947. Inventory accumulation continued in the aggregate but for the first half ot the year it was at only about half the rate of the preceding 6 months.

There are at least two reasons why the drop in this necessarily temporary and volatile demand did not precipitate any general decline. First, it came at a time when inventories had not yet been built up to a dangerously high level. They were still generally below rather than above the prewar relation to sales. There was little basis for any general and drastic inventory liquidation.

The second reason was that the decline in inventory accumulation was offset elsewhere--in the underlying strength of the deferred demands for durable goods, in the second round of wage increases which stimulated consumer buying, but most notably in the expansion of exports.

When the expectations underlying the cautious buying failed to materialize, there was a new wave of forward ordering, particularly on the part of retailers. The statistics are not yet available but it looks as though the further accumulation in the current 6 months would be at least as great as in the first half of the year.

By the end of 1947 total business inventories will be roughly 50 billion dollars. This compares with 42 billions at the end of 1946 and 32 billions at the end of 1945. Granting that much of the increase is due to higher prices, those

inventories will be more vulnerable than a year ago. There will be less reason for further additions and more reason to postpone buying whenever there are doubts as to the outlook for business or prices.

It would be foolish to attempt to predict just how long and to what extent inventory accumulation will continue. This segment of the market, however, is a potential source of weakness in 1948.

Net exports of goods and services, which are the third of our four markets, were already at the high annual rate of 5 billion dollars in the last half of 1946. In view of the limited quantities of gold and dollar exchange available to foreign countries to pay for those exports, any large further increase seemed unlikely. This conclusion underestimated the urgency of the needs, made more so by the extraordinarily severe winter in Europe. Also, as domestic buyers grew cautious more goods were available for export. The annual rate in the first half of 1947 was 10 billion dollars. This expansion served to offset the lower rate of inventory accumulation.

Ultimately, the shortage of dollar exchange was felt in added restrictions on imports from the United States. Our net exports declined almost one-third between the second and third quarters and the fourth quarter will probably be even lower. This, however, has not relieved the inflationary pressure on our economy because it coincided with another wave of domestic buying for inventory.

The future of the export market depends on the size of any foreign aid program. Whether this aid shows up in the national accounts as government expenditures, or as exports financed by loans, its over-all economic effect will be pretty much the same. It will take substantial additional aid, however, just to maintain the current rate of net exports in 1948.

Contrary to the anticipations of many people foreign aid does not look like a source of additional demand for the total national output in 1948. It can, however, be important in some commodities.

Consumer expenditures provide the fourth and by far the largest market for the national output. Having risen from an annual rate of 118 billion dollars in the first half of 1945 to 151 billions in the last half of 1946, these expenditures have increased another 10 percent in the last year. This uninterrupted rise is explained in part by the rise in personal income and in part by the willingness to spend a larger share of that income.

Changes in personal income are to a large extent, the result rather than the cause of changes in the value of national output. The amount that the individual has to spend, however, is determined in part by tax rates and by so-called transfer payments which are not earned in current production.

A notable example of these transfer payments is the payment of terminal leave bonds beginning in September 1947. There were 1,800 million dollars of these bonds outstanding, of which approximately half were cashed in the first month.

Both the amount and the rate of redemption are approximately the same as the soldiers' bonus in 1936. It looks as though the economic effect would also be similar--except that it is relative to a larger national output.

The actual spending of this nonrecurrent income will be spread over some months. Even so, it is large enough to be an important factor. It puts more buying power into the hands of consumers when they were already prepared to buy more than could be produced. This spending spree will have its aftermath in 1948.

The effect of the Government's fiscal position on the disposable income of individuals can be important in other ways. High taxes have operated to limit excess demand and thereby prevent an even greater increase in prices than has already occurred. Any cut in tax rates in 1948 will put more buying power in the hands of the public.

If or when there is a substantial decline in national output and income a substantial part of the difference will come out of business and personal taxes. At the same time unemployment benefits will increase automatically and other expenditures, such as the cost of farm price supports, will tend to rise. The net effect will be to cushion the decline because the value of goods produced will go down faster than the incomes left to buy them.

The willingness of consumers to increase their expenditures relative to their income has been an important source of additional demand contributing to the rise in national income over the last 2 years. Total consumer expenditures have already risen from the wartime low of about 75 percent of disposable personal income to over 93 percent. We do not know how much higher they may go under the pressure of deferred demands and accumulated savings but the possibilities seem limited.

The normal ratio in good prewar years was somewhere around 95 percent. Part of the balance in contractual savings such as insurance and mortgage amortization and part is the earnings of unincorporated businessmen which have been reinvested in their business and therefore are not available for personal consumption.

Since the end of the war the percentage of income spent for one category of expenditures after another has reached a peak and leveled off or declined. The only major items which consumers would take in substantially larger quantities if available today are automobiles and housing.

The potential increase in automobile production over the next year would permit consumers to increase their expenditures for this item by less than 2 percent of their total income. The possible increase in housing expenditures if rent controls should be completely removed will be a little greater. Presumably, however, any such increase will be, in part, at the expense of some reduction in expenditures for other things such as food.

To summarize the year's developments, the decline in the rate of inventory accumulation which was anticipated at the last Conference did occur in the spring. Equipment outlays leveled off and there was some hesitation in construction. Forward buying was curtailed, prices leveled off and there was some decline in industrial production.

The readjustment proved short-lived primarily because of the unexpected strength of export demand. By mid-year, buyers, whether of retail merchandise or construction projects, began to take the attitude that they could not afford to wait for lower prices which were not yet in sight. They became impressed with the urgency of European needs. Later the redemption of terminal leave bonds was voted and the short corn crop aggravated the rise in living costs with repercussions which could easily be anticipated.

We are now experiencing the results of that reversal of previously cautious buying attitudes. In the aggregate, the four markets are still sufficient to take all the country can produce and to maintain the upward pressure of excess demand with the resulting spiraling of prices, costs and incomes. Fundamentally this spiraling stems from the willingness and ability of buyers to pay the higher prices to get what they want.

The ease with which added costs can be passed along in higher prices has permitted and encouraged inefficiences and nonessential costs which would not be tolerated under more competitive conditions. It has permitted and encouraged wage increases which not only add to costs but also put still more buying power in the hands of the public. It has resulted in high profits, including the profits of unincorporated business and farmers, with much the same effect.

There are no immediate signs of the end of this boom. The wave of renewed buying which began around mid-year is still continuing. The full effect of the cashing of terminal leave bonds has not yet been felt. There is danger of another round of wage increases which, however reasonable or logical in the particular instances, will add a further fillip to the spiral of rising incomes, costs and prices.

It is also clear, however, that the economy will be more vulnerable to a readjustment from boom conditions in 1948 than it has been in 1947. The next time businessmen grow cautious, as they did last spring, inventories will be larger--thereby making it easier to postpone additional buying. The remaining deferred demands will be less urgent. Even with foreign aid, the situation in the spring of 1947, when the sharp increase in exports minimized the readjustments elsewhere, is not likely to be repeated.

It would be foolish to try to predict just when the downturn will occur. It may not happen at all in 1948. If it does occur in 1948 it is not likely to be a major recession. As yet there is little, if any, of the overbuilding which characterizes the end of a capital goods cycle.

While a decline in national income is quite possible beginning sometime in 1948, the year as a whole is not likely to compare too unfavorably with 1947. For the year 1947 the national income will be over 200 billion dollars. At the beginning of 1948 it is likely to be even higher. A substantial decline, beginning early in 1948, would still leave the year as a whole only moderately below 1947.

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